

North Pacific Fishery Management Council

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May 6, 2003

Dear Senators and Representatives:

In June 2002, the North Pacific Fishery Management Council, by a unanimous 11-0 vote, identified a specific rationalization program as its preferred alternative for rationalization of the Bering Sea/Aleutian Islands (BSAI) crab fisheries. The identification of a preferred rationalization program for these fisheries occurred at the behest of stakeholders and Congress, who had directed the Council to analyze several specific approaches to rationalization, as part of the Consolidated Appropriations Act of 2001 (Pub. L. No. 106-554). In August 2002, the Council provided you the requested analysis of the rationalization alternatives. At that time, the Council also informed you that it had delayed specification of certain provisions of the preferred rationalization program to allow for additional input from communities, participants, and the public. The new provisions complete identification of the "three-pie voluntary cooperative program," the Council's preferred alternative, for rationalizing the BSAI crab fisheries. The new provisions address several critical aspects of the program, including:

1. A **binding arbitration program** developed by a stakeholder committee, establishes a procedure that will guarantee all harvesters and processors a fair ex vessel price and at the same time reduce price disputes. This multi-stage approach includes setting a preseason fleet wide benchmark price, a period of normal price negotiations, and final offer binding arbitration for participants unable to agree on terms of delivery. The determination of the non-binding benchmark price, which would inform negotiations and binding arbitration, would utilize a process suggested by the "Steele Amendment" under which the arbiter would consider high prices from the previous season's binding arbitration. A clarification that only independent harvesters would receive B shares (which can be delivered to any processor regardless of processing share holdings) would further strengthen the independent harvester component of the fleet.
2. A suite of community protections including:
 - ▶ a two-year "cooling off period" during which processing shares must be processed in the communities where processing was historically conducted.
 - ▶ a right of first refusal in processing shares granted to community and Community Development Quota (CDQ) groups to protect communities that rely on crab processing.
 - ▶ a cap on the annual allocation of processing shares in the primary fisheries, which will increase competition for landings among processors and communities in years of high total harvests, without sacrificing the stability to processors and communities provided by processing share allocations.
 - ▶ community purchase rights that permit community and CDQ groups to purchase harvest and processing shares for the benefit of a community.
 - ▶ increased harvest share ownership caps for CDQ groups to permit CDQ groups to develop a larger interest in the fisheries to benefit their communities.

3. **The details of the captain and crew share (C share) allocation** including stringent “owner-on-board requirements” to ensure that C shares benefit active captains and crew.
4. **The details of sideboards** that will prevent participants in the crab fisheries from unfairly increasing their activities in other fisheries and protect communities dependent on these other fisheries
5. **The details of a comprehensive data collection program** to provide extensive information that will allow the Council to evaluate the impacts of the program in the future.

The arbitration program is one of several critical aspects of the program. The binding arbitration program is developed to balance the interests of the harvesting and processing sectors and to minimize price disputes. The negotiation process begins with a comprehensive market analysis and announcement of a non-binding benchmark price intended to inform both price negotiations and individual binding arbitration proceedings. The market report and price announcement provide an industry-wide indicator of a reasonable price. Use of that price to guide future binding proceedings will ensure that prices in individual transactions reflect industry standards and practices. A negotiation period follows these announcements during which parties are free to agree a price for deliveries. If the parties cannot reach a successful settlement, harvesters can unilaterally initiate a binding arbitration proceeding with any processor holding uncommitted processing shares.

The Council recognizes the importance of the binding arbitration system to all participants in the fishery. Because of the importance of the arbitration program to a fair balance of interests between the sectors, several arbitration structures were analyzed and considered by the Council, including a fleet wide arbitration program and the Steele Amendment, which would apply a highest arbitrated price to all arbitrated deliveries in each fishery. The arbitration system selected by the Council is a hybrid of several systems, including the fleet wide model and the “Steele Amendment”.

If the preferred arbitration program does not function as intended, the Council is committed to using a different arbitration structure to provide a fair price setting environment. Because of the completed analyses of these different structures, an alternative structure, such as the “Steele Amendment,” could be expeditiously adopted as part of the binding arbitration program should Council review of the program suggest that the arbitration program is not working as intended. If Congress approves this program, such explicit authority could be provided to the Council to ensure timely action to address problems that might arise.

Without doubt, this rationalization program is controversial. Yet, much of this controversy is generated by the Council’s insistence on recognizing and protecting the varied interests of those that depend on the fisheries, many of which would be neglected by a less comprehensive approach. While recognizing several competing interests, the program’s foundation is a cooperative structure that provides the opportunity for participants to realize benefits through synergies and coordination. In adopting this program the Council believes these interdependencies, rather than competitive conflict, will facilitate maximum benefits from this common resource. Similar benefits have been observed in the Bering Sea Pollock fishery under the AFA cooperatives.

The Council’s preferred alternative is a novel and innovative management program. The Council intends to assume responsibility for addressing any difficulties that arise under the program and is committed to rigorous periodic reviews. The comprehensive economic data collection program demonstrates the Council’s commitment to monitor performance of all aspects of the program, including the binding arbitration program. We hope that Congressional authorization of the program will provide explicit direction to the Council concerning its obligation to review and amend the program should any unanticipated negative impacts arise.

I have enclosed the Council's update on the preferred rationalization program, which summarizes the amendments that the Council has identified since the June 2002 meeting. Congressional authorization for the program, of course, is still necessary for adoption and implementation of the program. I hope the enclosed information is useful to the United States Congress as you consider legislation affecting these fisheries. Please contact our Council, through the office of the Executive Director, if you require further information.

Sincerely,

A handwritten signature in black ink, appearing to read "David Benton". The signature is fluid and cursive, with a large initial "D" and "B".

David Benton
Chairman

Update on Bering Sea and Aleutian Islands Crab Rationalization Program
Submitted to the U.S. Congress, April 2003

In June 2002, the North Pacific Fishery Management Council, by a unanimous 11-0 vote, identified a specific rationalization program as its preferred alternative for rationalization of the Bering Sea/Aleutian Islands (BSAI) crab fisheries. The identification of a preferred rationalization program for these fisheries occurred at the behest of stakeholders and Congress, who had directed the Council to examine fisheries under its jurisdiction to determine whether rationalization is needed and provide an analysis of several specific approaches to rationalization, as part of the Consolidated Appropriations Act of 2001 (Pub. L. No. 106-554). In August 2002, the Council provided you the requested analysis of the rationalization alternatives. At that time, the Council also informed you that it had delayed specification of certain provisions of the preferred rationalization program to allow for additional input from communities, participants, and the public. This report is to inform you that, after receiving input from stakeholder committees and a series of meetings, the Council has completed the development of all provisions of the preferred rationalization program. This report supplements the Council's report to Congress from August 2002 by providing a brief summary of the provisions of the Council's preferred rationalization alternative selected by the Council since its June 2002 meeting.

The new provisions complete the balancing of several different interests of the preferred alternative, a "three-pie voluntary cooperative program," identified by the Council last year. While recognizing several competing interests, the program's foundation is a cooperative structure that provides the opportunity for participants to realize benefits through synergies and coordination. These interdependencies, rather than competitive conflict, will facilitate maximum benefits from this common resource.

The Council developed the preferred alternative over the course of several years. The Council appointed a broad-based stakeholder committee in December of 2000 that developed alternatives for Council consideration, including a two-pie IFQ program with regionalization, on which the preferred alternative is based. A list of committee members is included in Attachment A. After considering several draft analyses, hearing hundreds of hours of public testimony, and refining the alternatives at several meetings, the Council identified the framework and most of the details of its preferred alternative at its June 2002 meeting. At that time, the Council deferred its decisions concerning some aspects of the program to provide industry, communities, the general public and other stakeholders with further opportunity to provide input. The Council appointed committees to develop options for four different components of the rationalization program, binding arbitration, community protections, captain and crew shares, and data collection. A list of the members of the members of these committees is also included in Attachment A. At its April 2003 meeting, the North Pacific Fishery Management Council completed the process of selecting a preferred rationalization alternative for the Bering Sea/Aleutian Islands crab fisheries. Relying on input from the committees and the public and subsequent analyses, the Council developed several additional provisions including:

- several provisions to protect community interests,
- a binding arbitration program to facilitate price negotiating and to resolve price disputes,
- a program that would allocate a portion of each fishery for the exclusive use of active captains and crew,
- measures to strengthen the independent harvester component of the fleet by allocating B shares to only independent harvesters

- a set of sideboards to protect participants in other fisheries, and
- a comprehensive data collection program to aid in Council review of the program.

These measures are discussed more fully below.

Price Setting and Binding arbitration

The Council's preferred alternative provides for the allocation of both harvest and processing shares. Class A harvest shares would be allocated for 90 percent of the total allowable catch (TAC) and would require delivery to a processor holding unused processing shares. The remaining 10 percent of the TAC would be allocated as Class B harvest shares, which can be delivered to any processor. At the April meeting, the Council took action to clarify that B shares would go only to independent harvesters. This was intended to strengthen the hand of harvesters in price negotiations and promote the economic well-being of the independent harvester fleet.

Processing shares would be allocated for 90 percent of the TAC, creating a one-to-one relationship between Class A harvest shares and processing shares. The protracted season in a rationalized fishery and the one-to-one relationship of harvest shares to processing shares limit markets available to participants in both sectors. To address potential price disputes and avoid disruptive strikes, which have occurred in the past, a broad-based industry committee developed a set of options for binding arbitration. From those options, the Council selected an arbitration program that is intended to facilitate price negotiations and minimize price disputes, while providing an effective forum for resolution of any disputes.

The arbitration program would apply only to A shares, which require delivery to a holder of processing shares. The arbitration standard, supported by a consensus of the industry committee, directs the arbitrator to identify a price that preserves the historic division of first wholesale revenues between the two sectors. Industry participants supported the historical division of revenues as a fair method of preserving the balance of interests of the two sectors in the fisheries. The arbitrator would be permitted to consider other relevant factors, such as changes in product markets and prevailing prices, when applying this standard.

The price setting and arbitration system consists of three parts. The first part is the setting of a benchmark price by an independent market analyst and arbitrator. This benchmark price would inform the second step of the process which is independent price negotiations among the participants in the fishery. These would be price negotiations similar to existing practices in the fishery. If these negotiations fail, then a binding arbitration mechanism is available to resolve disputes. The Council looked on this third step as a last resort when normal negotiations fail, and the program design reflects this intent.

The first step in the price settlement process would be the development of a market report and a non-binding price formula by an industry selected market analyst and arbitrator. The Council incorporated the methodology of the "Steele Amendment" into this stage to provide more clarity and direction in this process. In this process, the arbitrator who develops this non-binding price formula would consider the outcome of the binding arbitration proceedings from the previous year. Specifically, the highest arbitration price outcomes that apply to at least 7 percent of the market would be considered (as 7 percent of the market is viewed as sufficient to demonstrate a market trend that might appropriately affect all arbitrated prices). The non-binding price formula is intended to provide a benchmark price that will be a starting point for negotiations and minimize the number

of price disputes as negotiations progress. Participants are provided with latitude to settle a price that varies from the announced non-binding price to accommodate individual circumstances, such as delivery timing and location.

After a negotiating period, if normal price negotiations fail, harvesters can unilaterally initiate a binding arbitration proceeding with any holder of uncommitted processing shares by committing deliveries to that processor. The non-binding benchmark price would inform the arbitrator as to a reasonable price for deliveries.

This benchmark price, which would be using the arbitration standard and considering the methodology of the so-called Steele Amendment, would not be binding but would provide a clear baseline for consideration by the arbitrator in the binding arbitration proceedings. The final arbitrated delivery price could be changed by the arbitrator to accommodate the circumstances of the transaction after considering the benchmark price and the standards for arbitration. The arbitration proceeding would be final offer, under which the arbitrator is limited to choosing between two final offers submitted, one from each party.

Recognizing the importance of the price setting process to all participants in the fishery, the Council went beyond simple binding arbitration and adopted this multi-stage approach. Because of the importance of the arbitration program to a fair balancing of interests between the sectors, several arbitration structures were analyzed and considered by the Council, including a fleet wide arbitration program and a binding form of the Steele Amendment, under which the highest arbitrated price would apply to all arbitrated deliveries in each fishery. As noted, the Council chose to incorporate this Steele Amendment process into the development of the pre-season benchmark price. If the preferred arbitration program does not function as intended, the Council is committed to using a different arbitration structure to provide a fair price setting environment. Because of the completed analyses of these different structures, an alternative structure, such as the "Steele Amendment," could be expeditiously adopted as part of the binding arbitration program should Council review of the program suggest that the arbitration program is not working as intended.

Summary of community protection measures

The preferred rationalization program balances the interests of several communities that have depended on the Bering Sea/Aleutian Islands crab fisheries.¹ The Pribilofs depend on the crab fisheries as their economic base and could suffer from consolidation of activities in ports in the Aleutians and Alaska Peninsula that might be stimulated by slowing the race for fish. Adak is developing its crab industry after the recent departure of the military. Dutch Harbor has long depended on the crab fisheries and is home to several processors that support fleets in many fisheries. King Cove is highly dependent on a single processor active in crab and groundfish fisheries. Kodiak, historically depended on crab fisheries in the Gulf of Alaska, has maintained an interest in the more distant Bering Sea crab fisheries through its fleet and some of its processors. The community protection measures attempt to balance these competing community interests while allowing the participants to develop efficiencies in the fisheries. In assessing community interests it is important to note that the gains of one community are the losses of another community. Many of the measures are intended to provide community protections absent in a traditional harvester-only Individual Fishing Quota (IFQ) program.

¹ In addition to these community level protections, processing shares and the corresponding harvest shares are regionally designated requiring landing and processing in the region of the historic processing activity.

The allocation of 90 percent of the TAC as Class A harvester share, which must be delivered to a holder of processing shares, is intended to support communities' historic participation by tying quota to community-based processing. The allocation of processing shares for 90 percent of the TAC is intended to provide stability for the processing sector that maintains infrastructure in communities. The remaining 10 percent of the TAC would be allocated to harvesters as open delivery shares to provide economic opportunity for harvesters and communities that wished to compete for those deliveries. The allocation scheme is similar to the 90/10 split of the AFA pollock fishery under which each cooperative is required to land 90 percent of its harvests with its affiliated processor. The AFA structure has benefited harvesters, processors, and BSAI pollock dependent communities.

A two-year "cooling off period" would be established during which processing shares cannot be relocated from the community where the historical processing occurred that led to the allocation. The "cooling off period" is intended to provide a period of general stability for processors and communities to adjust to the program. At the beginning of share-based management, trading of shares could lead to rapid consolidation in the processing sector, as some processors choose to exit the fisheries. Although trading will be permitted during the "cooling off period," the requirement that shares stay in a community will provide communities and processors with the opportunity to work together to determine whether activity can be maintained in the community under the new management structure. This period should allow for thoughtful long range planning on the part of communities and processors.

A right of first refusal will be granted to community and Community Development Quota (CDQ) groups from communities with significant crab processing history on the sale of any processing shares for use outside of the community. The right of first refusal is a reasonable compromise reached by a committee comprised of representatives of communities, processors, and harvesters. The provision provides flexibility for companies to consolidate operations to achieve efficiencies, while providing a community and CDQ groups with a meaningful right to intervene on behalf of a community, if a local processor intends to sell its interest in the crab fisheries. A second right of first refusal would be granted to community groups from communities in the Gulf of Alaska with significant crab processing history on processing shares that are allocated based on processing history in Gulf of Alaska communities with minor processing activity in the crab fisheries. This provision is intended to aid Gulf of Alaska communities that wish to enhance their dependence on processing in the crab fisheries.

Caps on the amount of IPQs (or the annual allocation of processing shares) would be established in the two largest fisheries, the Bristol Bay red king crab and the Bering Sea *C. opilio* fisheries. In years of low abundance processor shares will provide stability to the processing sector and historically dependent communities. As stocks increase the caps will limit the allocation of processing shares providing opportunity for new processors and/or communities to participate and limits any potential windfall to historic participants. In the Bering Sea *C. opilio* fishery, the proposed 175 million pound cap was exceeded 5 times between 1990 to 2000 (slightly less than 50 percent of the seasons). Bristol Bay red king crab 20 million pound cap was exceeded 11 times in the last 33 years (33 percent of the seasons).

Community and CDQ groups would be permitted to purchase processing shares to enhance processing activity for their communities. In communities with significant history in the fisheries, these groups would be exempt from sea time requirements allowing their purchase of harvest shares. Groups would be required to manage and use the shares for the benefit of community residents. CDQ groups, who act on behalf of the many residents of their communities, would be governed by higher ownership caps than individuals purchasing shares in the fisheries. These higher caps are intended to provide CDQ groups with the latitude necessary to develop

a consolidated interest in the fisheries adequate to forward the interests of residents of the Western Alaskan CDQ communities.

The details of the captain and crew share (C share) allocation

The captain and crew share program will create a separate class of shares (C shares) that will be allocated to eligible captains. This three percent allocation will require the shareholder to be onboard the vessel fishing the shares and can be transferred only to active participants in the crab fisheries. These “owner-on-board” requirements should translate into share ownership by both captains and crew. Ownership caps enacted in the program are intended to ensure that a reasonable number of active captains and crew benefit from C share ownership.

The details of sideboards

Sideboard protections that limit participation in groundfish fisheries will apply to all vessels that receive an allocation in the *C. opilio* fishery. The sideboards will restrict these vessels to their historic harvests in all Gulf of Alaska groundfish fisheries (except the sablefish fishery, which is subject to the IFQ program harvest limitations). Vessels with minimal *C. opilio* harvests and substantial cod harvests would be exempt from the sideboard caps. In addition, vessels with minimal total groundfish landings in the qualifying period would be prohibited from harvesting cod from the Gulf of Alaska. These sideboards should be adequate to protect groundfish participants from an influx of effort because of excess vessels being removed from the crab fisheries upon implementation of the rationalization program.

The details of a comprehensive data collection program

A program to collect economic data from harvesting and processing sectors would be used to evaluate the success of the rationalization program. The program would collect revenue, employment, and variable cost data and any fixed cost data necessary to analyze variable costs. A third party entity will collect the data and provide it to analysts in a blind format to ensure confidentiality.

Conclusion

These additional provisions demonstrate the Council’s continuing commitment to balance the interests of those who depend on the Bering Sea/Aleutian Islands crab fisheries. The binding arbitration program is intended to protect both harvesters and processors from failed price negotiations by providing an alternative to strikes. Community protections are intended to safeguard those communities that relied on these fisheries to support their local economies. Requirements that holders of C shares actively fish those shares will ensure that those shares protect the interests of captains and crew. Sideboards will restrict participants in the BSAI crab fisheries from increasing harvests in other fisheries to protect historic participants in those other fisheries. The data protection program will facilitate review of the program to allow the Council to mitigate any unanticipated consequences. These new provisions are an integral part of the Council’s rationalization program. The program, as a whole, is a coherent management plan for these fisheries that balances the manifold interests of those who depend on these fisheries, while maintaining the environmental integrity of the fisheries demanded by the public.

Attachment A
Update of BSAI Crab Rationalization Report to Congress
Council Committees Related to Crab Rationalization

Crab Rationalization Committee

Dave Hanson – Chairman
Gordon Blue
Paula Brogdon
Tom Casey
Terry Cosgrove
John Garner
Don Giles
Leonard Hertzog
John Iani
Kevin Kaldestad
Frank Kelty
Linda Kozak
Brent Paine
Gary Painter
Joe Plesha
Dale Schwarzmiller
Jeff Steele
Jeff Stephan
Tom Suryan
Steve Minor
Arni Thompson
Karen Wood-Dibari

BSAI Crab Binding Arbitration Committee

John Garner – Co-chairman
Jake Jacobsen – Co-chairman
Gordon Blue
Lance Farr
Walt Christensen
Terry Leitzell
Garry Loncon
Gary Painter
Joe Plesha
Joe Sullivan

Attachment A (continued)
Update of BSAI Crab Rationalization Report to Congress
Council Committees Related to Crab Rationalization

BSAI Crab Community Protection Committee

Dave Hanson – Chair
Linda Freed
John Garner
Jon Hickman
Jeff Steele
Pat Carlson
Bob Juettner
Max Malevansky
Frank Kelty
Steve Minor

BSAI Crab Captain QS Committee

Stosh Anderson - Chairman
Tom Suryan
Rick Shelford
Coleman Anderson
Barney Olsen
Dan Jansen
Walter Christensen
David Hillstrand
John Klemzak
Tom Gibson
Kevin Kaldestad

BSAI Crab Data Collection Committee

John Garner - Co Chairman
Gary Painter - Co Chairman
Terry Cosgrove
Kevin Kaldestad
Terry Leitzell
Joe Plesha
Glenn Reed
Doug Wells

